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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

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| NATIONAL CREDIT UNION ADMINISTRATION BOARD AS LIQUIDATING AGENT FOR WESTERN CORPORATE FEDERAL CREDIT UNION,<br><br>Plaintiff,<br><br>vs.<br><br>ROBERT A. SIRAVO, et al.,<br><br>Defendants.<br><br>AND RELATED COUNTERCLAIMS. | No. CV 10-01597 GW (MANx)<br><br>**JOINT OPPOSITION TO NCUA'S MOTION TO DISMISS COUNTERCLAIMS [DOC. 196]**<br><br>Date: January 9, 2012<br>Time: 8:30 a.m.<br>Courtroom: 10<br>Hon. George H. Wu<br><br>Filed herewith: Declaration of Laura D. Smolowe |

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## I. INTRODUCTION AND SUMMARY OF ARGUMENT

The NCUA's motion to dismiss the Counterclaims seeking indemnity ("NCUA Memo," Doc. 196-1) ignores some of the key factual allegations on which the Counterclaims rest, and misapprehends the applicable legal principles. Correctly understood, those facts and legal principles require that the NCUA's motion be denied.

The NCUA agrees that this Court has subject matter jurisdiction over these Counterclaims but quibbles about allowable remedies. No matter: the law is clear that damages can be awarded, and that is all the Counterclaimants (the "Officers") seek.[1]

The NCUA argues for a narrow construction of the Officers' indemnification rights, but ignores that WesCorp's indemnification policy ("Policy 21") provides officers and employees with the maximum indemnification provided by California law, or the Model Business Corporations Act, whichever is greater. The NCUA also ignores that the Officers entered into their employment pursuant to Policy 21, and performed all their services for WesCorp under Policy 21. Only after the Officers completed their service did the NCUA cancel their D&O insurance and change its regulations in a retroactive attempt to deny them coverage. (Indeed, the NCUA advanced Defendant Sidley's defense costs for the better part of a year before changing its mind and denying him coverage too.)

The NCUA argues that a regulation it promulgated *after* the Officers completed their service under Policy 21 – *after* the NCUA filed this lawsuit – permits it to abrogate Policy 21 retroactively. This argument does not begin to satisfy the strict legal requisites for retroactive rulemaking and fundamentally

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[1] For convenience, as used herein, the term "Officers" refers to all of the remaining Defendants. Defendant Swedberg, however, was an employee of WesCorp during all relevant times alleged in the Complaint and Counterclaims and was never an officer.

conflicts with basic American jurisprudence. The NCUA's regulation is not retroactive on its face and lacks any statutory basis for abrogating vested rights. It also is not the right regulation: the NCUA does not even cite the regulation applicable to post-receivership situations.

The NCUA argues that a series of FDIC cases resting on an FDIC regulation that has no NCUA counterpart allow it to abrogate Policy 21 retroactively. Those cases have no application here: in each the claimant sued under the FDIC regulation, not a resolution or bylaw such as WesCorp's Policy 21.

The NCUA argues that the Officers cannot state a stand-alone claim for indemnity under California Labor Code section 2802. This Court, however, is not bound by the California Court of Appeal decision relied upon by the NCUA (because it is not the decision of the state's highest court), and this Court should not follow that decision (because it is contrary to the statute's plain language and legislative history). In any event, should the Court agree with the NCUA that section 2802 does not apply, the Court should grant the Officers leave to assert a counterclaim under Corporations Code section 7237, which, as the NCUA concedes, does apply.

Finally the NCUA argues that the Counterclaims are not ripe. Not so. Each Officer has already incurred defense costs. Those claims are ripe because the applicable indemnification provisions allow for payment of already-incurred fees and do not limit indemnification to claims that the Officers win. Further, as indemnified parties, each Officer has a claim that by statute is prior to the claims of the NCUA's Insurance Fund or the claims of the former members of WesCorp. This Court should not permit the NCUA to delay these Counterclaims and thereby attempt to subvert the statutory priorities that Congress established.

## II. STATEMENT OF THE COUNTERCLAIMS

The NCUA's summary of the Counterclaims in the "Background" section of its memo (NCUA Memo 3:12-8:2) is largely accurate but it omits certain allegations and legal background of which the Court can take judicial notice. Those items include the following:

In 1988, the NCUA amended its rules to encourage credit unions to provide indemnity and insurance for directors, officers and other employees. *See Compensation of Officials*, 53 Fed. Reg. 4992, 4993 (proposed Feb. 19, 1988) (proposing amendments to 12 C.F.R. § 701.33). The proposed amendment specifically stated that credit unions, in deciding to provide indemnity, could choose between state law and the American Bar Association's Model Business Corporations Act ("MBCA"). *Id.* With some changes, the NCUA adopted the proposed amendment, effective Sept. 7, 1988. *See Organization and Operations of Federal Credit Unions; Compensation of Officials*, 53 Fed. Reg. 29,640 (Aug. 8, 1988).[2]

Thereafter, WesCorp adopted its indemnification and insurance policy, in accordance with the amended rule. That policy, as later codified, became known as Policy 21.[3] The NCUA knew of and approved Policy 21. Burrell ¶ 336.

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[2] As amended in 1988, section 701.33(c) provides that:

> Indemnification shall be consistent either with the standards applicable to credit unions generally in the state in which the principal or home office of the credit union is located, or with the relevant provisions of the Model Business Corporation Act. A Federal credit union that elects to provide indemnification shall specify whether it will follow the relevant state law or the Model Business Corporation Act.

12 C.F.R. § 701.33(c)(2) (eff. Sept. 7, 1988).

[3] Policy 21 provides in relevant part:

> It shall be the policy of WesCorp to indemnify to the maximum extent permitted by either the laws of the State of California or the Model Business Corporation Act the following individuals for any liability asserted against them and expenses reasonably incurred by them in connection with judicial or administrative proceedings, formal or

(continued…)

Policy 21 requires indemnification to the maximum extent allowed by the laws of the State of California or the MBCA, whichever provides more indemnity. Burrell ¶ 337; Siravo/Swedberg ¶ 287. Policy 21 also requires purchase and maintenance of D&O insurance. Burrell ¶ 339; Siravo/Swedberg ¶ 289.[4] The Officers have fully performed – no aspect of Policy 21 is executory on their part. Burrell ¶¶ 365-368; Siravo/Swedberg ¶ 297. And the Officers have already incurred significant defense costs. Burrell ¶ 371; Siravo/Swedberg ¶¶ 293, 300.

After seizing WesCorp in March 2009, the NCUA canceled the Officers' insurance, refused to buy the other insurance offered to it, and refused to indemnify all but one of the Officers for their defense costs. The NCUA's refusal to pay defense costs (to all defendants except Sidley, whose defense costs the NCUA did pay for a time) first occurred as early as February 2010. Burrell ¶¶ 347-348. That refusal took place before the NCUA became a plaintiff in this case, before the NCUA filed its first complaint herein, and long before the adoption of the regulation on which the NCUA principally relies in making its motion.

The NCUA became the plaintiff in this case in August 2010 and started to liquidate WesCorp in October 2010. (Late in October, the NCUA stopped paying Sidley's defense costs.) Thereafter, the NCUA announced a claims process for creditors. The Officers each exhausted the claims process and

(…continued)

informal, to which they are or may become parties by reason of the performance of their official duties:

Current Officials
Former Officials
Current Employees
Former Employees

[4] The Officers have Counterclaims against the NCUA for its failure to provide insurance and its efforts to cancel the insurance that WesCorp had and thereby deny the Officers insurance coverage. Burrell ¶¶ 386-398; Lane ¶¶ 285-297; Sidley ¶¶ 330-338; Siravo/Swedberg ¶¶ 312-321. The NCUA's motion does not challenge those Counterclaims. NCUA Memo 6-7 n.6.

their administrative remedies. Burrell ¶¶ 349-350; Lane ¶¶ 261-262; Sidley ¶¶ 308-309; Siravo/Swedberg ¶¶ 290-291. The NCUA denied Sidley's claim (Sidley ¶¶ 308-309) and simply pocket-vetoed the others' claims by letting 180 days run without making any written response (Burrell ¶¶ 349-350; Lane 262-263). *See* 12 U.S.C. § 1787(b)(4)(a)(i); 12 C.F.R. § 709.6(c). The Counterclaims were timely filed shortly thereafter.[5]

## III. ARGUMENT

### A. The Court Has Subject Matter Jurisdiction Over the Counterclaims

As the NCUA concedes, this Court has jurisdiction to decide the Officers' claims for indemnity. NCUA Memo 10:5-13. Both statutes and regulations provide that this Court has jurisdiction over such claims where, as here, the NCUA has denied or not acted timely on the claims. *See* 12 U.S.C. § 1787(b)(6)(A); 12 C.F.R. § 709.7.[6]

The only issue, therefore, is what relief a district court can order, given 12 U.S.C. § 1787(g). The answer is that a district court has jurisdiction to award damages, or even declaratory relief, so long as the declaratory relief is functionally equivalent to damages. *See, e.g., Bruns v. Nat'l Credit Union Admin.*, 122 F.3d 1251, 1254 (9th Cir. 1997) (notwithstanding

[5] The Officers originally answered and counterclaimed in August. Doc. 157, 158, 159, 166, 170, 174. The parties met and conferred pursuant to C.D. Cal. L.R. 7-3 in October. That conference resulted in the Officers' agreement to drop roughly two-thirds of their affirmative defenses, and to amend their defenses and their Counterclaims. Doc. 182-183. The Officers then filed amended answers and Counterclaims. Doc. 190-193. The NCUA's motion to dismiss (Doc. 196) challenges the amended Counterclaims. In this Opposition, the amended Counterclaims are cited thusly: "Burrell ¶ __" refers to Doc. 192; "Lane ¶ __" refers to Doc. 193; "Sidley ¶ __" refers to Doc. 191; and "Siravo/Swedberg ¶ __" refers to Doc. 190.

[6] At first glance, 12 U.S.C. § 1787(b)(5)(E) appears to contradict 12 U.S.C. § 1787(b)(6)(A), but courts construing the like provisions of the FDIC's statute harmonize the two by holding that district courts can consider a claimant's denied claim *de novo*. *Bueford v. RTC*, 991 F.2d 481, 486 (8th Cir. 1993); *Rosa v. RTC*, 938 F.2d 383, 392 n.11 (3d Cir. 1991); *see Sharpe v. FDIC*, 126 F.3d 1147, 1152 (9th Cir. 1997).

section 1787(g), money damages against NCUA available under the Federal Tort Claims Act).

One of the cases NCUA cites (all of which rely on an analogous regulation governing the FDIC) makes clear that courts may hear damages-based claims – including those for declaratory relief that, in effect, seek only a declaration regarding damages. NCUA Memo 8:8-9:20. *See Freeman v. FDIC*, 56 F.3d 1394, 1399 (D.C. Cir. 1995) (holding that while 12 U.S.C. § 1821(j) precludes claims for "nonmonetary remedies," "serious due process concerns would be implicated if parties aggrieved by the FDIC's action as receiver were left entirely without remedies. In many cases, however, aggrieved parties will have opportunities to seek money damages or other relief through the administrative claims process provided in 12 U.S.C. § 1821(d), and their claims are ultimately subject to judicial review." (emphasis supplied)).

Other courts have come to the same conclusion. *See, e.g., Sharpe*, 126 F.3d at 1153 ("The damages claim is not affected by the jurisdictional bar imposed by § 1821(j). . . ."); *Hindes v. FDIC*, 137 F.3d 148, 161 (3d Cir. 1998) ("Courts uniformly have held that the preclusion of section 1821(j) does not affect a damages claim."); *Carney v. RTC*, 19 F.3d 950, 958 & n.3 (5th Cir. 1994) (holding that section 1821(j) only prevents declaratory relief that is an "attempt to 'restrain or affect'" an "exercise [of] authorized powers" and that "[n]aturally, we do not hold that § 1821(j) would bar all actions for declaratory relief against the receiver of a failed financial institution"); *MBIA Ins. Corp. v. FDIC*, --- F. Supp. 2d ----, 2011 WL 4721293, at * 16 (D.D.C. Oct. 6, 2011) (because of the limitation imposed by § 1821(j), "plaintiff is limited to its claim for damages"); *AmBase Corp. v. United States*, --- Fed. Cl. ----, 2011 WL 3891942, at *32 (Fed. Cl. Aug. 31, 2011) ("Awarding damages net of the receivership deficit does not 'restrain or affect the exercise of

powers or functions of the [FDIC] as a conservator or a receiver,' 12 U.S.C. § 1821(j), but is directed at assuring the integrity of the judgment for breach of contract." (brackets in original)); *Haney v. Castle Meadows Inc.*, 839 F. Supp. 753, 759 (D. Colo. 1993) (claim for "damages premised on rescission is not barred by § 1821(j)").

To the extent that the NCUA seeks to preclude an order that would require the NCUA to advance future legal fees on a going-forward basis,[7] the Officers hereby withdraw such requests.[8] But the Officers may, and therefore do, maintain their claim for damages for their unreimbursed attorneys' fees already incurred, including seeking such damages in advance of judgment, as well as their claims for future damages. Siravo/Swedberg, Prayer ¶¶ 3-4; Burrell, Prayer, ¶¶ 3-4; Lane, Prayer, ¶¶ 3-4; Sidley, Prayer, ¶¶ 3. Section 1787(g) in no way bars such relief.

### B. The NCUA Cannot Retroactively Strip Counterclaimants of Their Vested Rights to Indemnity

#### 1. The NCUA Misconstrues Policy 21

Well before the events that are the subject of this lawsuit, and pursuant to the regulation adopted by the NCUA in 1988 (12 C.F.R. § 701.33(c)(2)), WesCorp's board of directors adopted a resolution (later codified in WesCorp's book of policies as "Policy 21") that promised to indemnify its current and former officers and employees "to the maximum extent permitted by either" California law or the MBCA "for any liability asserted against them and expenses reasonably incurred by them in connection with judicial or

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[7] *See* NCUA Memo at 8 ("Besides seeking damages, Siravo and Swedberg explicitly seek an advancement and reimbursement order from the Court, and Sidley seeks declaratory relief including a declaration that he is entitled to advancement and reimbursement of costs while the action is pending.").

[8] Siravo/Swedberg withdraw paragraph 5 of their Prayer. Burrell, Lane and Sidley do not pray for such relief, only damages for fees already incurred.

administrative proceedings, formal or informal, to which they are or may become parties by reason of the performance of their official duties."

Policy 21 by its plain language expresses the commitment that WesCorp will indemnify (and insure) current and former officers and employees under either California law or the MBCA, depending on which confers the broader indemnity rights in a given case.[9] The NCUA has offered no justification for failing to abide by the agreements entered into by WesCorp years earlier. *See, e.g., Sharpe*, 126 F.3d at 1153 (holding, in the analogous FDIC context, the "ordinary principles of contract interpretation [apply] in examining the rights between the parties," and that, in that case, "[i] is beyond cavil that this failure to perform the express terms of the settlement agreement is a breach").

*Count 1 (MBS investments, against all Officers):* Here, at least as to the allegations in Count One, the MBCA confers the broader indemnity rights, so it applies. Section 8.51(a) of the MBCA defines the broadest scope for which a corporation may permissively indemnify its directors. Section 8.58, in turn, provides that this permissive indemnification becomes *mandatory* where the

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[9] Back in February 2010, when the NCUA initially denied the indemnity claims of WesCorp's directors and officers, it did so on the theory that Policy 21 was null and void because it did not choose in advance of a claim arising between California law and the MBCA. In response, the directors and officers showed that the NCUA had considered but expressly declined to adopt a rule forcing such a pre-claim choice of law. The NCUA makes a half-hearted attempt to revive that argument in a footnote. NCUA Memo 13 n.10. But the argument is still wrong. The NCUA's final regulation permits a resolution, like Policy 21, that permits a credit union to adopt an indemnification policy that affords its officers and employees with the broadest indemnity permissible under either state law or the MBCA *on a case-by-case basis*. *Organization and Operations of Federal Credit Unions; Compensation of Officials*, 53 Fed. Reg. 29,640, 29,641 (Aug. 8, 1988). Indeed, the NCUA deleted a provision from the initial proposed regulation that would have nullified an indemnification policy that failed to make an advance, blanket election for all claims. *Id.* (referring to *Compensation of Officials*, 53 Fed. Reg. 4992, 4993 (proposed Feb. 19, 2011)). It is, of course, far too late for the NCUA to change its mind now; courts reject agency reinterpretations of regulations adopted during litigation that contradict earlier agency interpretations. *See Akzo Nobel Salt, Inc. v. Fed. Mine Safety and Health Review Comm'n*, 212 F.3d 1301, 1304-05 (D.C. Cir. 2000).

corporation adopts a policy to indemnify its officers and employees. MBCA section 8.58 states in relevant part:

> (a) A corporation may, by a provision . . . in a resolution adopted . . . obligate itself in advance of the act or omission giving rise to a proceeding to provide indemnification in accordance with section 8.51 or advance funds to pay for or reimburse expenses in accordance with section 8.53.[10]

Section 8.53, in turn, expressly provides for the advancement of legal expenses.[11]

In adopting Policy 21, WesCorp obligated itself in advance to indemnify its officers and employees to the fullest extent permitted by the MBCA and "advance funds" to reimburse their legal expenses. Pursuant to section 8.58 of the MBCA, the NCUA must indemnify the WesCorp Defendants for their defense costs, as they are incurred. The Court should reject the NCUA's attempt to escape that obligation.

*Counts 5 and 6 (SERP, against Siravo and Swedberg):* As for the SERP allegations in Counts Five and Six, Policy 21 mandates indemnification under California law, which provides the maximum coverage. Siravo and Swedberg believe that the appropriate predicate for the SERP allegations is the indemnity provided by Labor Code section 2802. Should, however, the Court agree with the NCUA that section 2802 is not applicable, then the Court should look to Corporations Code section 7237, as the NCUA concedes.[12] *See* NCUA Memo 13:4-16 & n.11.

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[10] The relevant provisions of the MBCA are attached as Exhibit A to the Declaration of Laura D. Smolowe, filed herewith.

[11] Although section 8.53 applies to directors, section 8.56 provides for the advancement of fees to an officer "to the same extent as a director," and for expenses "incurred in connection with" a proceeding brought in the name of the corporation.

[12] Although not mentioned explicitly in the Counterclaims, as part of the relevant California law governing indemnity, section 7237 is incorporated as a basis for Policy 21's indemnity rights. If necessary, Defendants Siravo and Swedberg request leave to amend the Counterclaims to explicitly reference section 7237 in their First and Second Counterclaims.

The NCUA's argument that Labor Code section 2802 and Corporations Code section 7237 do not require indemnity until the end of a successful defense (NCUA Memo 13:17-14:2 & n.12) fails to accord with Policy 21's clear language offering the greatest level of indemnity. *See* Part III.D below. By adopting Policy 21 in order to provide the maximum indemnity under either California law or the MBCA, WesCorp's Board made the decision to advance fees as they are incurred.

In short, the NCUA must comply with WesCorp's promise to its officers and employees, via Policy 21, to offer the most indemnity available under either the MBCA or California law, on a case-by-case basis.

2. **The NCUA Cites the Wrong Regulation and Misinterprets It As Applying Retroactively**

The NCUA now argues, for the first time, that a federal regulation nullifies Policy 21's guarantees and gives the NCUA complete discretion to provide or deny indemnity as it pleases. NCUA Memo 10:16-12:18.[13] The NCUA never made this argument when it denied indemnity to most of the WesCorp directors and officers back in February 2010 or when it made an about-face and denied indemnity to Sidley at the end of October 2010 (having paid his defense costs until then). That is because the NCUA's new argument

[13] Via a "*Cf.*" citation, the NCUA also suggests that some Delaware cases give it discretion to deny indemnification. NCUA Memo 12:7-18. The short answer to this is that Delaware law has no relevance; Policy 21 rests on California law or the MBCA, whichever provides more indemnification. Even if Delaware law were to apply, these cases are inapposite. In *Gentile v. SinglePoint Fin., Inc.*, 788 A.2d 111, 113 (Del. 2001), indemnification was denied because the employee was the plaintiff. In *Thompson v. The Williams Cos., Inc.*, C.A. No. 2716-VCS, 2007 Del Ch. LEXIS 112, at *7, *11-*13 (Del. Ch. July 31, 2007), the court merely rejected the employee's argument that he could receive advancement of defense costs without signing an undertaking; here, all the Officers have agreed to sign undertakings. And in *Havens v. Attar*, C.A. No. 15134, 1997 WL 55957, at *13 (Del. Ch. Jan. 30, 1997), the court merely held that in the absence of a bylaw or resolution (such as Policy 21) making indemnification mandatory, the board of directors had discretion to refuse it. Of course, if the NCUA wishes to stipulate to Delaware law, the case is over, because Delaware's Business Judgment Rule clearly protects officers.

rests on a *post hoc* regulation it promulgated almost two years after seizing WesCorp and firing its directors and officers, and almost six month after the NCUA brought suit: that regulation is 12 C.F.R. § 701.33(c)(6), effective January 27, 2011. *See Fiduciary Duties at Federal Credit Unions,* 75 Fed. Reg. 81,378, 81,380-81,381, 81,386 (Dec. 28, 2010). The NCUA argues that this new regulation acts retroactively, and mid-litigation, to strip the Officers of their vested indemnity rights – rights created by a policy that the NCUA had urged WesCorp and other federal credit unions to adopt. Or, put differently, the NCUA argues that it can rewrite the law after the fact to escape legal obligations that it now finds inconvenient.

The history of this new subsection (c)(6) is murky at best. The proposed rule did not contain any subsection (c)(6) (or, for that matter, subsection (c)(7)). *See Fiduciary Duties at Federal Credit Unions,* 75 Fed. Reg. 15,574 (proposed Mar. 29, 2010). Exactly where subsection (c)(6) came from, or when, is a mystery. The discussion in the Federal Register of the final rule and the comments that led to it does not even refer to subsection (c)(6) by name. *See* 75 Fed. Reg. at 81,380-81,381. The closest it comes to an explanation is the bland statement that "[s]ome commenters stated that the proposed rule's silence on the advancement of expenses would also disadvantage FCUs [federal credit unions] in attracting directors. To alleviate this concern, the final rule permits the FCU to advance funds to pay or reimburse reasonable legal fees and other professional expenses to assist the official or employee in resisting lawsuits that the FCU considers meritless." *Id.* at 81,381. Thus, without notice or a comment period, the NCUA promulgated new subsection (c)(6), which it now argues deprives the Officers of any reimbursement of defense costs already incurred, and also of any indemnity, now or ever. NCUA Memo 10:16-12:18.

The NCUA's argument is wrong for at least three independent reasons, any one of which suffices to defeat it.

*First*, the NCUA cannot now say that the regulations that it enacted after it took over WesCorp retroactively operated to change Policy 21, which was in effect when the Officers' conduct occurred, and when the Officers were sued, "to give effect to the [NCUA's] prohibitions." NCUA Memo 10 n.9. The NCUA's footnote explanation – "following the effective date of the final rule, the [indemnification] policy or bylaw must be interpreted so as to give effect to the rule's prohibition" (*id.*) – only explains how current indemnification policies are interpreted. The NCUA and its rule say nothing about how indemnification policies in effect *before* that effective date are to be interpreted with respect to conduct occurring *before* that date, lawsuits filed *before* that date or claims for indemnity made – and rejected – *before* that date.

*Second*, nothing in the "legislative history" of section 701.33(c)(6) says it was intended to apply retroactively. Absent express statutory permission, and clear regulatory intent, regulations are ordinarily construed to be prospective in effect only and will not be given retroactive effect if they disturb vested rights. *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208-09, 109 S. Ct. 468, 471-72 (1988); *Tam v. FDIC*, No. CV 08–06458 MMM (AJWx), 2011 WL 5553986, ¶¶ 50-63 (C.D. Cal. Nov. 14, 2011) (citing, inter alia, *In re NOS Comm'ns, MDL No. 1357*, 495 F.3d 1052 (9th Cir. 2007)); *Henry v. FDIC*, 695 F. Supp. 2d 1063, 1078-82 (C.D. Cal. 2010).

More or less conceding the point, the NCUA does not cite the statute authorizing section 701.33(c)(6), or the new rule's "legislative history"; rather, it cites only a snippet of text in the announcement of a different rule in an entirely different part of the NCUA's regulations. NCUA Memo at 10-11 n.9 (citing *Golden Parachute and Indemnification Payments*, 76 Fed. Reg. 30,510, 30,511, 30,512 (May 26, 2011)). That rule, the NCUA admits, applies only "in

the limited circumstances described in the rule, *i.e.*, in the context of an administrative enforcement action brought by NCUA or the appropriate state regulatory authority." 76 Fed. Reg. at 30,511.

*Third*, nothing suggests that section 701.33 is even the operative regulation, post receivership. Other regulations (*e.g.*, 12 C.F.R. § 704.20(g) (eff. Jan. 18, 2011), superseded by 12 C.F.R. § 750.7 (eff. June 27, 2011) deal specifically with post-receivership indemnity.[14] In contrast, section 701.33 assumes the continued existence of the credit union and makes no sense as applied to failed credit unions. Indeed, the NCUA admits as much. NCUA Memo at 16:19-17:10.

Despite the NCUA's attempts to rewrite law and history after the fact in order to avoid legal obligations it finds inconvenient, it cannot rewrite Policy 21 now, after suing the Officers (and after paying the defense costs of one of them for the better part of a year), simply to deny them indemnity.[15] After all, the Officers took their jobs at WesCorp while Policy 21 was in force, and performed all the acts and omissions now at issue while Policy 21 was in force. This kind of retroactive rewriting of the rules offends our jurisprudence. As the Supreme Court said in *Landgraf v. USI Film Products*, 511 U.S. 244, 263-280, 128 L. Ed. 2d 229, 251-62, 114 S. Ct. 1483, 1496-

[14] When proposing sections 704.20(g) and 750.7, the NCUA explicitly said that these rules would apply only "to all new employment contracts entered into on or after that date [i.e., the effective date], as well as existing contracts that are renewed or modified in any way after that date." *Corporate Credit Unions*, 74 Fed. Reg. 65,210, 65,253-65,255 (proposed Dec. 9, 2009); *Golden Parachute and Indemnification Payments*, 75 Fed. Reg. 47,236, 47,237 (proposed Aug. 5, 2010).

[15] Nor can the NCUA deny indemnification on the theory (which it does not argue here, but does in its motion to strike) that the NCUA is not bound by WesCorp's commitments. The stipulation of May 11, 2011, which the NCUA signed, provides otherwise: "The NCUA as Liquidating Agent is by 12 U.S.C. § 1787(b) the successor to WesCorp and the NCUA as Conservator, and therefore is the proper party against which Defendants' claims, counterclaims, cross-claims and affirmative defenses arising out of the acts or omissions of WesCorp and the NCUA as Conservator and/or Liquidator are to be asserted in this action; …." Doc. 125, at 2:21-26. *See also Sharpe*, 126 F.3d at 1153.

1505 (1994), "the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted. For that reason, the 'principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal'" (citations and footnotes omitted).

### C. The Counterclaims Do Not Assert Claims Under FDIC Regulations

Citing a number of FDIC and RTC cases from the 1990's, all of which arose under 12 C.F.R. § 545.121 (as amended Dec. 26, 1995) — which does not apply to credit unions and was not promulgated by the NCUA — the NCUA argues that these cases bar the Officers from seeking indemnity here. NCUA Memo, part II.A, 14:9-17:10. The short answer is that the Officers are not suing under 12 C.F.R. § 545.121 or any other regulation, but rather under WesCorp's Policy 21 (to which the NCUA is the successor) and under California law or the MBCA. Therefore, section 545.121 and the cases cited by the NCUA are irrelevant and inapposite.

To start, section 545.121 is a regulation promulgated by the late Office of Thrift Supervision that has no parallel in the NCUA's regulations. Section 545.121 mandated indemnification of directors, officers and employees in sharply limited circumstances. In contrast, since 1988 the NCUA's regulations have permitted indemnification in accordance with state law and/or the MBCA. Thus, the limitations of section 545.121, which drove the outcomes in the cases cited by the NCUA, have no application here.

*Adams v. RTC,* 831 F. Supp. 1471, 1747-49 (D. Minn. 1993), to which the NCUA devotes almost a page (see NCUA Memo 14:11-15:11), illustrates

this point.[16] In *Adams*, the directors claimed indemnification pursuant to section 545.121, not pursuant to corporate policy or resolution such as Policy 21. The court denied indemnification pursuant to the terms of a acquisition between the failed savings and loan and its successor institution (831 F. Supp. at 1478; *see also id.* at 1474) and also held that the language of the acquisition agreement "does not contravene the mandatory indemnification requirements of 545.121." *Id.* at 1478. The language from this opinion quoted by the NCUA (NCUA Memo 15:7-11) deals with the interplay between this acquisition agreement and section 545.121, neither of which has any conceivable application to our case here.

Similarly, *RTC v. Eason*, 17 F.3d 1126, 1134-35 (8th Cir. 1994); *RTC v. Gregor*, No. 94-CV-2578, 1995 WL 931093, at *3 (E.D.N.Y. Sept. 29, 1995); *RTC v. Atherton*, Civ. No. 92-5261 (GEB), 1994 U.S. Dis. LEXIS 21427, at *12 (D.N.J. Sept. 9, 1994); and *RTC v. Baker*, No. Civ. A. 93-0093, 1994 WL 637359, at *7 (E.D. Pa. Nov. 14, 1994) all consider claims for indemnification arising under section 545.121, not a policy or resolution such as Policy 21.

*Eason* is illustrative. The RTC sued the directors and officers of a failed savings and loan, accusing them of breach of fiduciary duty and negligence in making some "participation loans." 17 F.3d at 1129. The defendants won a jury trial, at least in part on the strength of the bank examiners' notes, which described two of the loans using the words "excellent investment," and the examiners' examination reports, which gave the bank's underwriting practices a letter grade of B on an A to F scale. *Id.* at 1130. The RTC appealed, challenging the admission of this evidence, and the defendants appealed,

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[16] The NCUA's citation suggests that the Eighth Circuit affirmed the ruling in the RTC's favor on the indemnification point. NCUA Memo 14:19-21. Not so. In the Eighth Circuit, the RTC was the only appellant, and it appealed other unrelated points it had lost below, and that it lost again on appeal. The appellate opinion says nothing about indemnification. *Adams v. Greenwood*, 10 F.3d 568 (8th Cir. 1993).

challenging the district court's refusal to award them attorneys' fees under the Equal Access to Justice Act, 28 U.S.C. § 2412(b). *Eason*, 17 F.3d at 1130-36. The Eighth Circuit rejected both appeals. It ruled that the examiners' notes and reports were admissible. *Id.* at 1130-34. It also denied fees, but only on the ground that section 545.121 – the predicate for the fees claim – by its terms applied only to ongoing financial institutions, not institutions in conservatorship or receivership. *Id.* at 1134-35.

The NCUA's other cases – *Atherton*, *Baker* and *Gregor* – add nothing to the discussion. Like *Adams* and *Eason*, these unpublished decisions dismiss Counterclaims under section 545.121. Nothing in any of them purports to bar indemnity claims arising under other law (such as the MBCA) or bylaws or resolutions.

The only case cited by the NCUA where the claim for indemnity did not rest solely on section 545.121 – but instead on an indemnification bylaw – is the one case that squarely rejects the *Adams/Eason* line of authorities. In that case, *RTC v. Scott*, 929 F. Supp. 1001, 1025-27 (S.D. Miss. 1996), *vacated on other grounds*, 125 F.3d 254 (5th Cir. 1997), the defendant, Scott, the president and CEO of a failed bank, won summary judgment on the merits of the RTC's claims (breach of contract, breach of fiduciary duty, and negligence), and also won an award of attorneys' fees and costs pursuant to the bank's bylaw awarding defense costs only if "'final judgment on the merits is in such person's favor ...'" *Scott*, 929 F. Supp. at 1025. The district court squarely rejected the notion that the RTC, via section 545.121, could avoid an indemnification bylaw. *Id.* at 1025-27. The court also rejected the notion that the FDIC statute providing for director and officer liability (12 U.S.C. § 1821(k)) somehow *sub silentio* voided pre-existing indemnification obligations. 949 F. Supp. at 1026. The Fifth Circuit vacated the decision not on the merits but on exhaustion grounds. In so doing, the appellate court made

it clear that it found no impediment (save for exhaustion) to Scott recovering defense costs from the assets of the failed institution. *Scott*, 125 F.3d at 260.

There is no issue of exhaustion here. The Counterclaims plead exhaustion, and NCUA Memo 4:16-25, 10:5-13 concedes the point.

**D. The Officers Have Viable Counterclaims for Indemnification Under California Law**

Regardless of the applicability of Labor Code section 2802, the NCUA concedes that Corporations Code section 7237 applies to the claims at issue. *See* NCUA Memo 13:4-16 & n.11. Accordingly, should the Court conclude that indemnity is not available under section 2802, the Officers respectfully request an opportunity to amend to bring counterclaims under section 7237.

Both Labor Code section 2802 and Corporations Code section 7237 provide for indemnification of individuals in the Officers' position. *See* Cal. Lab. Code § 2802(a) (requiring indemnification whenever the employee incurs expenses as a "direct consequence of the discharge of his or her duties"); Cal. Corp. Code § 7237(c) ("A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action by or in the right of the corporation . . . if such person acted in good faith, in a manner such person believed to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances" ).[17]

Both in addition allow for the advancement of fees, and neither requires the Officer to succeed on a claim in order to recover. Section 2802 contains no prevailing party requirement or other relevant limitation and therefore, by its terms, allows for reimbursement of fees incurred at any point. *See Cassady*

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[17] Indemnification is mandatory if the employee prevails in the action. Cal. Corp. Code § 7237(d).

*v. Morgan, Lewis & Bockius LLP*, 145 Cal. App. 4th 220, 230, 51 Cal. Rptr. 3d 527, 534 (2006) (holding that "as long as the employee is acting within the scope of his or her employment the right to indemnity is not dependent upon a finding that the underlying action was unfounded." (citation omitted) (emphasis supplied)); *Nicholas Labs., LLC v. Chen*, 199 Cal. App. 4th 1240, 1248 n.3, 132 Cal. Rptr. 3d 223, 229 n.3 (2011) ("But the statute on its face contains no prevailing party requirement.").

For its part, Corporations Code section 7237 explicitly allows for advancement upon the execution of an undertaking, and allows for indemnity even after a finding of liability where the court "determine[s] that, in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for the expenses which such court shall determine." Cal. Corp. Code § 7237(c)(1); *see id.* § 7237(f) ("Expenses incurred in defending any proceeding may be advanced by the corporation prior to the final disposition of such proceeding upon receipt of an undertaking by or on behalf of the agent to repay such amount unless it shall be determined ultimately that the agent is entitled to be indemnified as authorized in this section.").[18] Because WesCorp adopted Policy 21 to provide the maximum indemnification under the MBCA or California law, section 7237's obligation to indemnify is mandatory upon execution of the required undertaking.

As for the applicability of section 2802, the Officers agree that *Nicholas Labs* is on point. *See* 199 Cal. App. 4th 1240, 132 Cal. Rptr. 3d 223 (2011). However, with due respect to the state appellate court, this Court may disregard that opinion upon convincing evidence that the California Supreme Court would rule otherwise. *See, e.g., Owen By and Through Owen v. United States*, 713 F.2d 1461, 1464-65 (9th Cir. 1983) (declining to apply Court of

[18] All the Officers have offered to provide the necessary undertaking.

Appeal decision where "convincing evidence exists that the highest court of a state will not follow the result reached by some of that state's inferior appellate courts"); *see also Wilson v. Haria and Gogri Corp*, 479 F. Supp. 2d 1127, 1136-38 (E.D. Cal. 2007) (rejecting application of California Court of Appeal decision where reasoning of decision was contrary to plain meaning and legislative history of statute).

The Officers submit that the reasoning in *Nicholas Labs* is inconsistent with the text and legislative history of section 2802 and that this Court may on that basis come to a contrary conclusion. This is because *Nicholas Labs* disregards the fundamental purpose and public policy that underlie the statute. *See Nicholas Labs*, 199 Cal. App. 4th at 230-31.

The plain language of the statute – covering "all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties" – by its terms covers claims by employers as well as third-party claims. *O'Hara v. Teamsters Union Local No.* 856, 151 F.3d 1152, 1160 (9th Cir. 1998) (analysis of section 2802 begins with the language).

Supporting that plain language, section 2802 arises out of, and codifies, California's "strong public policy that favors the indemnification (and defense) of employees by their employers for claims and liabilities resulting from the employees' acts within the course and scope of their employment." *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 952, 81 Cal. Rptr. 3d 282, 293, 189 P.3d 285 (2008). The legislative history of section 2802 shows that it was amended in 2000 with the specific purpose of expanding indemnity to cover attorney's fees so as to "put section 2802 on equal footing with other wage and hour protections in the Labor Code." Decl. of Laura D. Smolowe, filed herewith, Ex. B, at 14-15 (Senate Rules Committee, Office of Senate Floor Analysis, SB 1305 (Aug. 23, 2000) (excerpted from Legislative History for 2000 Amendment to Cal. Labor Code section 2802, 2000 Ch. 990, S.B.

1305, compiled by Legislative Intent Serv., Inc.). As California's wage and hour protections are particularly robust, this legislative history evidences an intent to elevate indemnity to the same level. *See, e.g., Gentry v. Superior Court*, 42 Cal. 4th 443, 456, 64 Cal. Rptr. 773, 781-82, 165 P.3d 556 (2007).

Moreover, the two Ninth Circuit cases relied upon by the state appellate court in fact support the Officers' position. *See O'Hara*, 151 F.3d at 1161 (granting indemnity under section 2802 to an employee who was sued by an employer); *Freund v. Nycomed Amersham*, 347 F.3d 752 (9th Cir. 2003) (emphasizing that section "2802 is designed to indemnify employees for the legal defense costs when they are sued for actions arising out of their employment.").

The NCUA also argues that section 2802 is trumped by Corporations Code section 7237. *See* NCUA Memo 17:23-19:8. Notwithstanding the NCUA's argument otherwise, however, it is actually section 2802 which is later in time. As noted above, section 2802 was amended in 2000 specifically to expand indemnity rights to cover attorney's fees. Further, a specific statute only trumps its more general counterpart if the two "cannot be reconciled." *Los Angeles Police Protective League v. City of Los Angeles*, 27 Cal. App. 4th 168, 178, 32 Cal. Rptr. 2d 574, 579 (1994). The NCUA has not suggested that this is the case. The Officers submit that the two sections are entirely consistent: two statutes which indemnify officers in suits by their employer companies and which allow for advancement of fees.

Regardless of the Court's conclusion, the Officers wish to make clear they are preserving the issue for appeal.

E. **The Counterclaims Are Ripe**

The NCUA's argument that the Counterclaims are not ripe (NCUA Memo 19:9-20:10) fails for multiple reasons:

*First*, each of the Officers has already incurred substantial litigation expenses for which he is entitled to be reimbursed under Policy 21, the MBCA and California law (either Labor Code section 2802 or Corporations Code section 7237).

*Second*, these provisions do not require the Officers to prevail in this litigation in order to be reimbursed for the attorneys' fees that they have already incurred that arise out of the performance of their duties for WesCorp. Policy 21 was intended to provide officers and employees with the maximum indemnification, including the reimbursement of attorneys' fees already incurred, provided under either the MBCA or California law.

*Third*, the Officers, as indemnified parties, are general creditors of WesCorp who take priority over the accountholders and shareholders and members of WesCorp, as well as any reimbursement of the National Credit Union Share Insurance Fund. *See* 12 C.F.R. §§ 709.1(e) (as amended May 17, 2004) (defining "shareholder" as "members, nonmembers, accountholders or any other party or entity that is the owner of a share, share certificate or share draft account or the equivalent of such accounts under state law."), 709.5(b)(5)-(6) (as amended Oct. 25, 1999) (stating that "general creditors" take priority over "shareholders"). Thus, the Officers' claims for indemnification should be paid in full before the Liquidating Agent pays any of the uninsured portions of the claims of "shareholders" of WesCorp, anything to the National Credit Union Share Insurance Fund or any distribution of surplus funds to "shareholders" of WesCorp.

## IV. **CONCLUSION**

For each of the foregoing reasons, the Court should deny the NCUA's motion to dismiss and let discovery go forth as to the Counterclaims.

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